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Chief Executive Officer

November 10, 2011

To: Mayor Michael D. Antonovich
Supervisor Gloria Molina
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Don Knabe

From: William T Fujioka
Chief Executive Officer

GOVERNOR BROWN'S TWELVE-POINT PENSION REFORM PLAN

Governor Brown recently announced a Twelve-Point Pension Reform Plan that generally applies to all public employee pension systems throughout California. The recommended reforms would apply to newly hired employees and, in some cases, existing employees.

The attached information includes a brief summary of the Governor's proposal and our comments as to the potential impact on the County's pension program. You will note that parts of the proposal may have limited application to the County due to the existing design of the County's pension plans and the significant reforms that were implemented more than 30 years ago. Certain changes may also pose vested rights issues with respect to existing employees.

If you have any questions, please contact me at (213) 974-1101 or Jim Adams at (213) 974-2404.

WTF:BC:JA
MTK:WW:mst

Attachment

c: Executive Office, Board of Supervisors
County Counsel
Auditor-Controller

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Below is a summary of Governor Brown's Twelve-Point Pension Reform Plan with comments relating to the potential County impact.

1. **Equal Sharing of Pension Costs: New Employees and Existing Employees**

The Governor is proposing that employee contributions pay for at least half the cost of public employee pensions. This change would apply to both new and existing employees and, according to the recommendation, would be phased-in in a way that takes into account existing contribution levels and the collective bargaining process.

Comment:

We have two open contributory retirement plans commonly known as General Member Plan D and Safety Member Plan B. In the case of Plan D, employee contributions are already geared to pay approximately half the normal cost of the program, and are actually tracking at 46% according to the Los Angeles County Employees Retirement Association's (LACERA) Actuarial Valuation of Retirement Benefits as of June 30, 2010. No portion of these contributions is picked-up by the County. Given these circumstances, we believe Plan D is operating in a manner generally consistent with the Governor's recommendation.

In the case of Safety Plan B, employees are paying 29% of total contributions due to a limited pick-up of employee contributions that was initiated in 2001 through the collective bargaining process. 29% is material, but less than the 50% standard set out in the Governor's proposal. Imposition of that standard would, therefore, reduce the County's costs associated with Safety Plan B, but would undoubtedly generate union demands for other salary or benefit trade-offs.

It is not clear how the Governor's proposal would impact a noncontributory plan such as the County's Plan E.

2. **"Hybrid" Risk-Sharing Pension Plan: New Employees Only**

The Governor has proposed a "hybrid" risk-sharing retirement plan for new employees. This plan would offer employees a scaled down defined benefit plan combined with a "401(k) type" defined contribution plan. This would effectively shift a portion of the risk associated with investment returns to the defined contribution plan and the participating employees. When combined with Social Security, this arrangement is envisioned to replace 75% of the employee's salary based on a full career.

For public employees who do not participate in Social Security, the defined benefit component of the hybrid plan would be designed to replace two-thirds of The 75% target benefit, and the defined contribution plan would make up the remaining one-third.

Comment:

The Governor's proposal on this item contains very limited detail. Until additional information is released, we cannot assess its impact. We can point out, however, that the County currently offers employees a combination of defined benefit and defined contribution plans but does not participate in Social Security. The defined benefit plans are among the lowest cost plans available under the County Employees Retirement Law of 1937 (CERL), and, as noted above, much of the cost of these benefits are paid for by employee contributions.

3. **Increase Retirement Ages: New Employees Only**

The Governor's proposal notes that public employee pension enhancements have permitted many employees to retire at increasingly early ages while life expectancies have been increasing. This circumstance has increased the pension benefits that many employees receive from the point of retirement to end of life, and that has put a financial strain on many pension systems.

The Governor is recommending that new employees be required to work to a later age to qualify for "full retirement benefits" and he is specifically recommending that this age be tied to the age at which full Social Security benefits are payable (age 67 for most new employees). For safety employees, the Governor is proposing an unspecified lower age with the understanding that the age ultimately identified must be commensurate with the ability of those employees to perform their jobs in a way that protects public safety.

Comment:

The age at which an employee receives "full benefits" is generally considered the age at which pension benefits are no longer reduced on account of age. This is commonly known as the "normal retirement age" in pension plan parlance, and, as noted, would be age 67 under the Governor's proposal. Without more details on the defined benefit component of the aforementioned hybrid plan recommendation, it is not possible to determine the impact of this particular change. However, we should note that the normal retirement age under both Plan D and Plan E is 65. Therefore, we are currently within two years of the proposed standard as it relates to non-safety personnel.

We should also point out that the County's open pension plans are designed to replace approximately 60% to 80% of pre-retirement income for career employees. This is a target that is generally consistent with the 75% target set out in the Governor's proposal. For example, a Plan E participant who retires at age 65 with 35 years of service receives a benefit approximately equal to 70% of pre-retirement income. A similarly situated Plan D participant receives approximately 85 %, but approximately half of the cost of that benefit is paid for with employee contributions. A Safety Plan B participant who retires at age 55 with 30 years of service receives approximately 79%, and pays for a substantial portion of that benefit.

4. **Require Three-Year Final Compensation to Stop Spiking: New Employees Only**

Some public employee pension plans base pension benefits on a single year of "final compensation." This can encourage pension spiking through manipulation of an employee's salary during his or her final year of employment. The Governor is proposing that final compensation for new employees be determined based on the highest average compensation over a three-year period.

Comment:

The County's non-contributory Retirement Plan E already makes use of a three-year final compensation period. Plan D and Safety Plan B, however, are based on a single year final compensation period.

5. **Calculate Benefits Based on Regular, Recurring Pay to Stop Spiking: New Employees Only**

The Governor's proposal addresses the definition of pensionable compensation to exclude special bonuses, unplanned overtime, payouts for unused vacation or sick leave, and other pay perks that can be manipulated to increase pension benefits.

Comment:

For Los Angeles County, pensionable compensation is defined by CERL and related court decisions. The Governor's recommendation would reduce costs and pension spiking potential for new employees.

6. **Limit Post-Retirement Employment: All Employees**

Under current law, retired public employees may be re-hired on a limited temporary basis with no interruption of their pension benefits. The Governor is proposing that this type of employment be limited to no more than 120 days per year. He is also proposing that retired employees who serve on public boards or commissions be prohibited from earning any additional retirement benefits for that service.

Comment:

CERL already provides for a 120-day limit on the hiring of retired employees. It also prohibits the earning of additional pension benefits for service on public boards or commissions.

7. **Felons Forfeit Pension Benefits: All Employees**

The Governor's plan will require that public officials and employees forfeit pension and related benefits if they are convicted of a felony in carrying out official duties, in seeking an elected office or appointment, or in connection with obtaining salary or pension benefits.

Comment:

This limitation does not currently exist within CERL. It may pose a vested rights issue with regard to existing employees. Staff will continue researching and will confer with counsel on this issue.

8. **Prohibit Retroactive Pension Increases: All Employees**

The Governor's proposal would prohibit retroactive pension increases for service that has already been provided. It would effectively limit any future pension enhancements to future service.

Comment:

This change would eliminate the windfall effect that happens whenever a pension plan enhancement is applied to past service. It would significantly reduce the demand/temptation for such enhancements.

9. **Prohibit Pension Holidays: All Employees**

Certain public employers have suspended employer and employee contributions to pension systems when investment returns have been strong and the systems have seemed to be fully funded. In many instances, those actions later proved to be detrimental to the funding of the systems. The Governor's proposal would prohibit these types of "pension funding holidays."

Comment:

This is a meaningful change which will strengthen retirement plans.

10. **Prohibit Purchases of Air Time: All Employees**

"Air Time" refers to the purchase of additional retirement service credit for service that was not actually worked. Under certain pension systems, including CERL systems, eligible employees may purchase a limited amount of Air Time by paying the full actuarially determined cost of that time. The Governor's proposal would eliminate this option on a State-wide basis.

Comment:

Although the CERL Air Time statute requires the affected employees to pay the full actuarially determined cost of the service credit in question, any actuarial estimate is an educated "guess" and could, conceivably, expose the County to potential liability. The availability of Air Time may also encourage employees to retire sooner than would otherwise be the case. We must confer with counsel as to whether it poses a vested rights issue with respect to existing employees who have not yet exercised this option under existing law.

11. **Increase Pension Board Independence and Expertise**

The Governor's proposal would add two independent, public members with financial expertise to the California Public Employees' Retirement System (CalPERS) Board to require real independence and sophistication to ensure that retirement funds deliver promised retirement benefits over the long haul without exposing taxpayers to large unfunded liabilities.

Comment:

Mandated only for State employees and does not apply to Los Angeles County.

12. Reduce Retiree Health Care Costs: State Employees only

The Governor's proposal would require new State employees to work for 15 years to become eligible for the State to pay a portion of their retiree health care premiums. They will be required to work 25 years to become eligible for the maximum State contribution to those premiums. The Governor's plan would also change the anomaly of retirees paying less for health care premiums than current employees. Finally, the State would require all retirees to look to Medicare to the fullest extent possible when they become eligible.

Comment:

Mandated only for State employees and does not apply to Los Angeles County. However, the cost of retiree healthcare is an important issue and staff is working on proposals for Los Angeles County.

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